Appendix F (Part 1)

***The Bank of New York Mellon v. Jefferson Cnty., Ala.*, No. 2:08-cv-01703**
Memorandum Opinion
(N.D. Ala. June 12, 2009)

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U.S. DISTRICT COURT
N.D. OF ALABAMA

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

THE BANK OF NEW YORK MELLON, et al.	}	
Plaintiffs,	}	
v.	}	**Case No.: 2:08-CV-01703-RDP**
JEFFERSON COUNTY, ALABAMA, et al.,	}	
Defendants.	}	

MEMORANDUM OPINION

This matter is before the court on Plaintiffs' Emergency Motion for Appointment of a Receiver ("Plaintiffs' Receivership Motion"). (Doc. #8). For the reasons explained below, the court finds that: (1) Plaintiffs have made a sufficient factual showing that they are entitled to the remedy of a receiver; but (2) the Johnson Act prohibits the appointment of a receiver with the power to directly or indirectly affect rates; and (3) the court should abstain from appointing a receiver even with limited powers. The court is fully aware that this result may seem counterintuitive[1] – at least in light of its findings of fact herein. Nonetheless, it is convinced this is the legally correct outcome.

I. Procedural History

On September 16, 2008, Plaintiffs, The Bank of New York Mellon ("BONY"), Financial Guaranty Insurance Company ("FGIC"), and Syncora Guarantee, Inc., f/k/a XL Capital Assurance Inc. ("Syncora"), filed this action against Defendants, Jefferson County, Alabama (the "County"),

[1]Perhaps the matter could be oversimplified by saying that Plaintiffs are entitled to prevail on the facts, but the County wins on the law.

Bettye Fine Collins, Bobby Humphryes, Jim Carns, George Bowman,[2] and Sheila Smoot. (Doc. #1). In their Complaint, Plaintiffs allege that the County has defaulted on certain contractual obligations related to its borrowing of substantial sums of money. Shortly after filing their Complaint, Plaintiffs also filed an emergency motion asking the court to appoint a receiver over the County's Sewer System (the "Sewer System"). (Doc. #8). The parties have extensively briefed that issue and the court has held two evidentiary hearings on Plaintiffs' Motion. (*See e.g.*, Docs. #9, 11, 30-34, 36-37, 61, 72-76, 79-92).

As the court has consistently and repeatedly reminded the parties, this complex, divisive, and heated controversy will not (and cannot) be satisfactorily resolved by way of any court order – whether from this court or any other. With this reality in mind, the court has, for the past eight months, attempted to give the parties the time and resources to come to a resolution. Unfortunately, this controversy cannot be settled without the cooperation of third parties not before the court. Even more regrettably, those third parties – including the Alabama Legislature and the Jefferson County Legislative Delegation – have not cooperated in seeking a solution to this crisis. There are undoubtedly a number of reasons for that. One of the principal reasons would appear to be politics.[3] Thus, despite the fact that the Special Masters – especially Judge John Ott – have made herculean efforts in encouraging a consensual resolution of the financial crisis underlying this lawsuit, the matter raised by Plaintiffs' motion is now under submission with this court. At the last hearing, Plaintiffs vigorously urged the court to stop efforts to foster a settlement and rule on their motion "up

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[2]Upon Bowman leaving the Jefferson County Commission, and being replaced by William Bell, Bell was substituted for Bowman as a party. *See* Order of November 14, 2008.

[3]As Ronald Reagan once quipped, "It has been said that politics is the second oldest profession. I have learned that it bears a striking resemblance to the first."

or down." The court is convinced of two things. First, that strategy is unwise because it abandons, at least temporarily, Plaintiffs' (particularly the Trustees') best avenue for resolving this matter. Second, notwithstanding the wisdom (or lack thereof) of their request, we have reached the point where Plaintiffs are entitled to a ruling on their motion.

II. Findings of Fact

The court makes the following findings of fact with respect to Plaintiffs' Receivership Motion. (Doc. #8).[4]

A. The Issuance of Warrants and the Trust Indenture

In connection with making required improvements to Defendant Jefferson County's Sewer System, between 1997 and 2003, the County borrowed approximately $3.6 billion in funds through the issuance of various sewer warrants ("Warrants"). The Warrants are secured by a lien on the revenues generated by the Sewer System that remain after payment of "Operating Expenses." There are approximately $3.2 billion in Warrants that remain outstanding.

The Trust Indenture is a document that was entered into by the County upon the issuance of Warrants and sets forth certain obligations of the issuer (the County) in favor of the purchasers of the Warrants. When Warrants are sold, the County essentially borrows money from the general public, the purchasers of the Warrants. The Trust Indenture is the contract that outlines the terms and conditions of the borrowing. The Indenture Trustee, one of the Plaintiffs in this action, is an independent institution that serves pursuant to the terms of the Trust Indenture. The Indenture

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[4]To a large degree the court's findings are based upon the parties' most recent joint submission. (Doc. #71).

Trustee's function is to represent the holders of the Warrants and ensure that the issuer of the Warrants (*i.e.*, the County) lives up to its responsibilities, as set forth in the Indenture.

B. The County's Historical Approach to Revenue and Debt Service

As early as 1997, the County understood that sewer rates would need to be raised in order to service the then-existing Warrant debt. On February 12, 1997, the Jefferson County Commission approved an amendment (the "Rate Ordinance Resolution") to the County's Sewer Use/Pretreatment Ordinance dated May 11, 1982 (the "Rate Ordinance"). The Rate Ordinance Resolution authorized the County, in connection with the financing of the original sewer debt (and the February 1, 1997 Trust Indenture) to make a "Rate Covenant" designed to maintain net revenues sufficient to service the County's annual debt service on the Warrants. The "Rate Covenant" in the Indenture provided for periodic, automatic rate increases in certain circumstances and was designed to ensure the County's ability to service its debt.

In 2002, Paul B. Krebs and Associates, Inc. ("Krebs"), an engineering firm, as was then its usual and annual practice for the County, analyzed potential sources of revenue for the County's Environmental Services Department ("ESD"). The ESD is the County Department responsible for operating the Sewer System. Krebs issued a report on March 31, 2003 (the "2003 Krebs Report") which concluded that the County required additional revenue to meets its debt obligations and that it should consider various options in addition to rate increases. Tellingly, this 2003 report stated that there can be "no debate about the urgency for action."

C. The County's Decision to Switch to Auction-Rate and Variable-Rate Financing

In a risky attempt to minimize the interest rate costs to the County over the 40-year life span of the various Warrants, between 2001 and 2003 the County issued a substantial amount of variable-

rate demand Warrants and auction-rate Warrants, which took the place of the more conservative, traditional fixed-rate Warrants. Two series of Warrants, the Series 2003-B and Series 2003-C Warrants, in an aggregate principal amount in excess of $2.2 billion, were issued subsequent to the County's receipt of the 2003 Krebs Report. All but a small portion of the Series 2003-B and Series 2003-C Warrants bore interest at either a variable rate or an auction rate, subject to swap agreements that were sold to the County in an attempt to fix the rates synthetically.[5] The 2003 Krebs Report, which concluded that the County required additional revenue to meet its then-existing debt obligations, was not attached to any official statement or public documents relating to the issuance of the Warrants.[6]

The debt at issue was primarily incurred to finance certain remediation projects required under a 1996 Consent Decree relating to the County's Sewer System. The 1996 Consent Decree was entered into between the County and the United States Environmental Protection Agency to settle a lawsuit over violations of the Clean Water Act by the County's Sewer System. The remediation work has been fraught with fraud and abuse. Twenty-one former Jefferson County officials or contractors who worked on the Sewer System remediation projects have been indicted and/or convicted of federal crimes related to those projects.[7] Some of these convictions were for bribery

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[5]To be sure, the County originally borrowed (and was loaned) far too much money. Even before the County refinanced the lower, fixed-rate Warrants, there is little question that it would not have been able to pay back the funds borrowed within the time period of the payment schedule.

[6]Further, the County entered into – and still has outstanding – thirteen separate interest rate swap agreements (the "Swap Agreements") with various financial institutions in a current aggregate notional amount of approximately $5.4 billion.

[7]At the March 26, 2009 receivership hearing, David Denard, the Director of the ESD, testified that he found himself in the position of Director over the ESD after everyone in authority over him had been convicted of crimes relating to these projects.

of public officials. Three former County Commissioners have been convicted of crimes related to work on the Sewer System. One former Commissioner has pled guilty to accepting bribes in connection with the Warrant transactions and the swap transactions at issue. Another former Commissioner not only has been sued civilly by the Securities and Exchange Commission for allegedly accepting bribes in connection with these transactions, but also, along with two others involved in the transactions, has been indicted in connection with the alleged bribes.

D. The County's Purchase of Municipal Bond Insurance

Upon the issuance of the Warrants, the County purchased municipal bond insurance policies in an attempt to make the Warrants more marketable. These policies were issued to the County by Plaintiffs Syncora and FGIC.[8] At the time these policies were purchased, Syncora and FGIC were AAA rated insurers. The interest rates on the variable-rate demand Warrants and auction-rate Warrants fluctuate based upon many factors, including the financial condition of the entities guaranteeing those Warrants. The interest rates on the County's Warrants, other than its fixed-rate Warrants, have increased during 2008 for a variety of reasons, including the downgraded ratings of its bond insurers Syncora and FGIC.

E. The Relevant Terms of the Indenture

In the Indenture, the County made a number of promises to the purchasers of its Warrants, including the following:

Section 12.5, "Maintenance of Rates," provides as follows:

> (a) The County hereby covenants and agrees to fix, revise, and maintain such rates for services furnished by the System as shall be

[8]Non-party Financial Security Assurance ("FSA") insures approximately $352,000,000 in Warrants.

> sufficient (i) to provide for the payment of the interest and premium (if any) on and the principal of the Parity Securities [Warrants], as and when the same become due and payable, (ii) to provide for the payment of the Operating Expenses and (iii) to enable the County to perform and comply with all of its covenants contained in the Indenture.

Section 13.1, "Events of Default Defined," defines certain Events of Default as follows:

> (a) failure by the County to pay the principal of or the interest or premium (if any) on any Parity Security [Warrant] as and when the same become due as therein and herein provided (whether such shall become due at maturity or by redemption, acceleration or otherwise);
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> (b) failure by the County to satisfy the Rate Covenant, provided that any such failure shall not constitute an Event of Default if (i) the Trustee receives evidence satisfactory to it that an increase in the rates charged for services furnished by the System has occurred pursuant to the provisions of the ordinance of the County that governs such rates, or (ii) the County employs a utility system consultant to review the System and its existing rates and fees and makes a good faith effort to comply with the recommendation of such consultant;
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> (c) failure by the County to perform or observe any agreement, covenant, or condition required by the Indenture to be performed or observed by it [other than its agreement to pay the principal of and the interest and premium (if any) on the Parity Securities or the Rate Covenant] after thirty (30) days' written notice (which said notice must state that it is a notice of default hereunder) to it of such failure given by the Trustee or by the Holders of not less than twenty-five percent (25%) in aggregate principal amount of the Parity Securities then outstanding hereunder, unless during such period or any extension thereof the County has recommended and is diligently pursuing appropriate corrective action; ... .

In Section 13.2, "Remedies on Default," the County agreed that "upon the occurrence and continuation of any Event of Default, the Trustee shall have the following rights and remedies,"

> (a) Upon the occurrence and continuation of any Event of Default described in clause (a) of Section 13.1 hereof, the Trustee shall, and, upon the occurrence and continuation of any other Event of Default described in Section 13.2 hereof, the Trustee may, declare the Parity

> Securities [Warrants] to be immediately due and payable, whereupon they shall, without further action, become and be immediately due and payable, anything in this Indenture or in the Parity Securities to the contrary notwithstanding.
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> (b) The Trustee may, by civil action, mandamus or other proceedings, protect, enforce and compel performance of all duties of the officials of the County, including the fixing of sufficient rates, the collection of revenues, the proper segregation of the revenues of the System and the proper application thereof and may, without limitation of the foregoing, proceed to protect and enforce its rights and the rights of the Parity Securityholders by a suit or suits, whether for the specific performance of any covenant or agreement herein contained or in execution of aid or any power granted herein or for the enforcement of any other proper, legal or equitable remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce its rights and the rights of the Parity Securityholders hereunder.
>
> (c) The Trustee shall be entitled upon or at any time after the commencement of any proceedings instituted with respect to an Event of Default, as a matter of strict right, upon the order of any court of competent jurisdiction, to the appointment of a receiver to administer and operate the System, with power to fix and charge rates and collect revenues sufficient to provide for the payment of the Parity Securities and any other obligations outstanding against the System or the revenues thereof and for the payment of expenses of operating and maintaining the System and with power to apply the income and revenues of the System in conformity with the Act and the Indenture.

Section 17.3 of the Indenture, "Miscellaneous Special Provisions Respecting the Bond Insurer and the Bond Insurance Policy," provides,

> (a) In determining whether a payment default has occurred or whether a payment on the Series 1997-A Warrants or Series 1997-B Warrants has been made under the Indenture, no effect shall be given to payments made under the insurance policy.

F. The County's Failure to Make Payments and Receipt of Forbearance Agreements

In April 2008, the County was unable to make certain required principal payments on the Warrants. The County entered into forbearance agreements with various financial institutions ("Liquidity Banks") delaying the due date on these payments. On or about June 2, 2008, the County made a principal redemption payment on the Warrants from its own funds in partial reduction of the April 1 Redemption Payment. On or about August 1, 2008, the Liquidity Banks, the County, and the Bond Insurers entered into additional forbearance agreements. In those agreements, the Liquidity Banks agreed to accept payments in the aggregate amount of approximately $79 million in payment of a portion of the April 1 Redemption Payment, a portion of the July 1 Redemption Payment, and certain interest that had previously been deferred, and also granted a forbearance until November 17, 2008. On or about August 1, 2008, the County made a principal redemption payment on the Warrants from its own funds in the approximate amount of $44 million in partial reduction of the payments required by the August 1, 2008 forbearance agreements.

On or about August 29, 2008, the Liquidity Banks and the County entered into another forbearance agreement until September 30, 2008. Neither FGIC nor Syncora entered into any forbearance agreement with the County after the termination of the August 1, 2008 forbearance agreements on August 29, 2008.

As a result of the County's failure to make certain payments due on the Warrants, the Indenture Trustee made claims on each of FGIC, Syncora, and FSA under their respective insurance policies. Plaintiffs Syncora and FGIC have made substantial principal payments on the County's

Warrants which the County did not make when due pursuant to redemption notices respecting the Warrants.

The County failed to make payments of principal installments due on the Warrants (Parity Securities under the Indenture), called for redemption on June 1, 2008, August 1, 2008, and October 1, 2008, pursuant to the terms of the Indenture and certain Standby Warrant Purchase Agreements. Sewer System net revenues are not sufficient to service the County's current debt obligations. Further, the County has failed, pursuant to the Indenture, to fix, revise, and maintain rates that are sufficient to make required principal payments. The County has not raised sewer rates since January 2008, pursuant to the Rate Covenant or otherwise, despite the fact that Sewer System net revenues are not sufficient to service the Sewer System's current debt obligations.

Plaintiffs[9] initiated this action on September 16, 2009. In their Complaint, Plaintiffs assert the following claims: Count I - for the Appointment of a Receiver Pursuant to Indenture; Count II - for the Appointment of a Receiver Pursuant to Alabama Law; Count III - for Enforcement of Consent Decree; Count IV - for the Appointment of Interim Receiver; Count V - Mandamus (only against the Commissioners) (seeking compliance with the terms of the Indenture); Count VI - for Specific Performance of Obligations Under the Indenture; and Count VII - for Breach of Standby Warrant Purchase Agreements. (Doc. #1).

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[9]The County has argued that Syncora and FGIC lack standing to assert claims made in the Complaint. Regardless of whether the Insurers lack standing to bring this action, it is undisputed that The Bank of New York Mellon, as Indenture Trustee, does have standing and has asserted, on behalf of the Warrant holders, all the claims made against the County and the Commissioners.

III. Legal Analysis

Shortly after filing their Complaint, on September 23, 2009, Plaintiffs filed an Emergency Motion for the Appointment of a Receiver over the Sewer System of Defendant Jefferson County, Alabama. (Doc. #8). After permitting discovery, conducting pre-hearing conferences, and permitting the parties time to seek a voluntary resolution of this controversy, on March 26, 2009, the court held an evidentiary hearing on the issue of whether Plaintiffs were entitled to the appointment of a receiver. Just days before that hearing, for the first time, Defendants raised a number of issues with regard to whether this court has jurisdiction to hear this case and decide the issues raised in Plaintiffs' Emergency Motion for the Appointment of a Receiver. All of these matters have now been fully briefed, and an additional evidentiary hearing was conducted on June 1, 2009. (*See generally* Docs. #71-96).

A. The Remedy of Appointing a Receiver Over the Sewer System is Warranted by the Facts of This Case

The appointment of a receiver over the Sewer System is a remedy that was agreed to by the County at the time it executed the Indenture, in the event it violated certain of its obligations under the Indenture. The Eleventh Circuit has unequivocally stated that courts sitting in diversity should follow federal law in making the determination of whether to appoint a receiver. *National Partnership Inv. Corp. v. National Housing Development Corp.*, 153 F.3d 1289, 1291-92 (11th Cir. 1998) ("[F]ederal law governs the appointment of a receiver by a federal court exercising diversity jurisdiction."). Moreover, federal courts have recognized in certain cases involving private sector entities that appointment of a receiver is appropriate where the parties have contractually agreed to a receivership. *See, e.g., Britton v. Green*, 325 F.2d 377, 382 (10th Cir. 1963); *Garden Homes, Inc.*

v. U.S., 207 F.2d 459, 460 (1st Cir. 1953); *American Bank and Trust Co. v. Bond Intern. Ltd.*, 2006 WL 2385309, *7 (N.D. Okla. 2006) ("Appointment of a receiver is appropriate where the parties have contractually agreed to a receivership."); *Pioneer Capital Corp. v. Environamics Corp.*, 2003 WL 345349, *9 (D. Me. 2003) (concluding that "the existence of an express contractual right to appointment of a receiver, coupled with 'adequate prima facie evidence of a default,' can be sufficient to warrant such an appointment"); *Okura & Co. (America), Inc. v. Careau Group*, 783 F. Supp. 482, 499 (C.D. Cal. 1991) (finding that the appointment of a receiver pursuant to a Deed of Trust and Security Agreement was necessary to protect the plaintiff's interest).

Section 13.2 of the Indenture provides that the appointment of a receiver is a remedy available for "the occurrence and continuation of any Event of Default, ..." Plaintiffs have alleged nine different types of Events of Default by the County:

1. Failure to pay principal on the Warrants when due on each of June 2, 2008, August 1, 2008, October 1, 2008, January 1, 2009, February 20, 2009, and April 1, 2009;

2. Failure to fix, revise, and maintain rates which are sufficient to pay debt service obligations, as required under § 12.5(a) of the Indenture;

3. Failure to make increases in rates and charges as necessary to comply with § 12.5(b) of the Indenture;

4. Failure to comply with the Rate Covenant set forth in § 12.5(b) of the Indenture;

5. Failure to deliver to the Trustee by December 10, 2008, notice of the County Finance Director's determinations and conclusions, as required under § 12.5(c) of the Indenture;

6. Failure to increase sewer rates on January 1, 2009, as required under § 12.5(c) of the Indenture;

7. Failure to make required deposits into the Debt Service Fund, Reserve Fund, Rate Stabilization Fund, and Depreciation Fund, as required under § 11.1 of the Indenture;

8. Failure to satisfy the Reserve Fund Requirement, as required under § 11.3 of the Indenture; and

9. Failure to make required deposits into the Reserve Fund as a result of the Insurers' downgrades, as required by § 11.11 of the Indenture.

(Doc. #86 at 28; Doc. #89 at 16-44).

In issuing the Warrants and borrowing money from the general public, the County agreed that, upon the commencement of any proceedings instituted with respect to an Event of Default, that "as a matter of strict right, upon the order of any court of competent jurisdiction," the Trustee would be entitled "to the appointment of a receiver to *administer and operate* the System . . .." Indenture Section 13.2(c) (emphasis added).

The evidence is overwhelming (if not undisputed) that the County has engaged in – and is continuing to engage in – Events of Default. For example, it has not made certain required principal payments; it has failed to fix, revise, and maintain rates which are sufficient to pay its debt obligations; it has not complied with the Rate Covenant; it has failed to comply with the notice requirements under Section 12.5(c) of the Indenture; and it has failed to make payments into various funds as required under Section 11.1 of the Indenture. Thus, the question here is not whether the County has defaulted, but whether the court should appoint a receiver as a remedy for those Events of Default.

"Courts have recognized many factors that are relevant for a court to consider when determining the appropriateness of the appointment of a receiver. These include fraudulent conduct on the part of the defendant, ...; imminent danger that property will be lost or squandered, ...; the

inadequacy of available legal remedies, ...; the probability that harm to the plaintiff by denial of the appointment would be greater than the injury to the parties opposing appointment, ...; the plaintiff's probable success in the action and the possibility of irreparable injury to his interests in the property, ...; and whether the interests of the plaintiff and others sought to be protected will in fact be well served by the receivership, ..." *Consolidated Rail Corporation v. Fore River Railway Co.*, 861 F.2d 322 (1st Cir.1988) (citations omitted); *see also Santibanez v. Wier McMahon & Co.*, 105 F.3d 234 (5th Cir.1997). Below, the court examines each of these factors in order, and also looks at the question of whether equitable principles counsel against enforcing this particular term of the Indenture.

1. Whether There Has Been Fraudulent Conduct on the Part of the Defendant

Plaintiffs contend that there is at least an appearance of fraudulent conduct on the part of the County given what they describe as "massive corruption" surrounding the County's Sewer System construction and issuance of Warrants. They also assert that the County, since 2003, has suppressed information that would indicate that its sewer revenues were insufficient to meet its debt obligations. The court will discuss these assertions in turn.

To date, twenty-one former Jefferson County officials or contractors who worked on the Sewer System remediation projects have been indicted for federal crimes related to those projects. David Denard, the current Director of the ESD, testified at the March 26 hearing that he found himself in the Director position after everyone in a position of authority over him in the ESD had been convicted of crimes relating to these projects. Three former County Commissioners have been convicted of crimes related to the Sewer System. One former Commissioner has pled guilty to accepting bribes in connection with the re-financing of the Sewer System debt. Another former

Commissioner not only has been sued civilly by the Securities and Exchange Commission for allegedly accepting bribes in connection with such transactions, but also, along with two others involved in the transactions, has been indicted in connection with the alleged bribes.

Plaintiffs have also presented compelling evidence that the County has been aware, since at least March 2003 (if not before), that its net sewer revenues were insufficient to service its debt load. It was in March 2003 that the County received the 2003 Krebs Report. Despite issuing additional Warrants later in 2003, it did not reveal this information to potential investors. The County utilized the Krebs firm from 1997 to 2003 in order to evaluate the adequacy of sewer system rates and charges. Prior to 2003, the reports issued by Krebs were generally optimistic about the County's ability to service the required debt payments from its sewer revenues; indeed, the County routinely attached these reports to its Official Statements for the various Warrant issuances to support the notion that net system revenues were adequate to meet its operating and debt service requirements. However, the 2003 Krebs Report presented a much bleaker picture: it explicitly stated that the size of the sewer debt presented a major problem for the County, and warned that the County would need a dramatic 89% increase in sewer revenue to meet its future debt obligations. Krebs recommended that the County take immediate action to raise additional system revenue, and warned that if it did not do so, the consequences would be severe. As the 2003 Krebs Report stated:

> [W]hen the alternative of obtaining revenues through a plan over which the Commission has some control is compared with the action of a receiver should the system go into default, there can be little question as to which course of action would be preferable. There can also [be] no debate about the urgency for action; this is not a matter on which action can be long deferred without serious consequences.

2003 Krebs Report. Jt. Ex. 35.

Rather than heed this warning, the evidence before the court suggests that the County suppressed the 2003 Krebs Report and took little (if any) steps to generate the additional revenues which would be required to meet the looming sewer debt crisis. Even worse, the County refinanced more than $2 billion of its fixed-rate Warrants to auction and variable-rate Warrants,[10] and in doing so did not disclose the existence of the 2003 Krebs Report to any of the Warrant purchasers.

Based on the foregoing, the court finds the record which is now before the court is replete with evidence of fraudulent conduct and suppression by the County and its various representatives.[11] Therefore, the evidence before the court on this factor weighs in favor of appointing a receiver.

2. Whether There is an Imminent Danger that Property Will be Lost or Squandered

The County has frequently asserted, in this litigation and elsewhere, that the only recourse available to Plaintiffs and the Warrant holders is the net revenues of the Sewer System. The evidence presented to the court indicates that the County has for years known that System revenues (the only recourse available) were insufficient to cover its obligations on this debt. There is also evidence that, despite this knowledge, for years the County failed and/or refused to investigate whether sewer revenues were (1) maximized and (2) sufficient to cover the County's debt obligations related to the System. One member of the County Commission, whose responsibilities include overseeing the Sewer System, has not only refused to take action, but has openly advocated reducing

[10]The May 1, 2003 and August 5, 2003 Warrant issuances were projected to result in an average annual savings to the County of 15.1% for the first seven years. Savings were projected to be negative for several years thereafter. Obviously, these issuances fell far short of resolving the County's impending revenue shortfall.

[11]This is not to say that there is not evidence of fraudulent conduct by other parties. However, that information is not relevant to the current inquiry.

sewer rates, declaring bankruptcy,[12] and/or making payments from net sewer revenues that are insufficient to service the debt load.

Plaintiffs have presented evidence that the County has been wasting available System revenues for years. The mismanagement is evidenced by the fact that the County has ignored the advice of consultants who since 2003 have warned the County that its financial condition was unsustainable. For example, the court has already detailed the evidence relating to the County's ignoring (and suppressing) the Krebs Report. But there is more.

The County's failure to address its crisis has developed into a pattern of inaction over the years. In 2003, after receiving the Krebs Report, the County retained new advisors – the professional firm of BE&K, Inc. ("BE&K") – to study the problem. BE&K issued a report advising that "sewer rates must be increased" beyond the automatic increases under the County's Rate Ordinance Resolution. The report forecasted that the County's projected sewer rate increases would be insufficient to cover its debt obligations and that "a level 12.5-percent increase in 2004 through 2011 would meet needed revenue requirements and help stabilize rate increases." Jt. Ex. 37. The County, however, did not raise rates in the manner recommended by BE&K.

In 2007, the County retained another professional firm, Red Oak Consulting ("Red Oak"). Red Oak issued a report advising the County that if the debt service costs became higher than initially projected, the County would need "significant" increases to its sewer rate revenues in order

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[12]In fairness, at the June 1, 2009 evidentiary hearing, each of the Commissioners, including Commissioner Carns, indicated that they did not then believe bankruptcy to be a suitable option. In response to inquiries from the court, they also each said they were willing to jointly agree to the retention of a consultant to examine whether rates are reasonable, and whether rates should be raised or reduced. It was Plaintiffs who balked at this idea.

to service the debt. The Red Oak report also recommended other revenue enhancements. Again, none of these recommendations were adopted by the County.[13]

In the face of consistent input from rate experts that net sewer revenues were insufficient to operate and pay its debt obligations, the County went in the *opposite* direction. It suspended the automatic rate increase that was due for 2009 under the County's automatic rate adjustment resolution. Accordingly, even today, rates remain at the same level at which they were set on January 1, 2008.

The most recent example of the County's refusal to deal with its sewer debt crisis can be seen in the County's response to the Special Masters'[14] Report, dated January 20, 2009 and its snail-like pace in engaging yet *another* rate consultant. The Special Masters' Report contains numerous substantive recommendations for increasing revenues and decreasing expenses. Plaintiffs have presented evidence demonstrating that, at least since early 2008, the Commissioner in charge of the

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[13]In addition, in May 2008, counsel for FGIC and Syncora retained the professional firm R.W. Beck, Inc. ("R.W. Beck") to conduct an assessment of the System and to identify potential revenue enhancements and expense reductions, separate and apart from volumetric sewer rate increases, which could be implemented by the County to assist with meetings its debt obligations. Darrell Cline of R.W. Beck issued a report (the "Cline Report") which made a number of recommendations about how to increase revenues. These recommendations were discussed with the County in or about May 2008 and R.W. Beck's draft report detailing these recommendations was provided to the County in October 2008. In November 2008, the County stipulated that the revenue enhancements proposed by the Cline Report (other than the Clean Water Fee, 15% residential discount, and the termination of the private water meter program) are potential sources of revenue that should be examined by the County Commission (Jt. Stmt. ¶85); yet, to date, the County Commission has not adopted any of the Cline Report proposals.

[14]John Young was the County's nomination to serve as Special Master. Plaintiffs nominated John Ames. By Order dated November 25, 2008, the court appointed Mr. Young and Mr. Ames to serve as co-Special Masters to investigate the System and make recommendations regarding, *inter alia*, enhancement of revenues, rates, and potential reductions in expenses.